



P.0616

PRIME MINISTERBritish Aluminium Company Ltd

(Secretary of State for Industry's minute of 10 December; E(EA)(81)43 &amp; 45)

## BACKGROUND

You already know some of the background from Lord Plowden's letter to you of 7 December. The main points are as follows:

- a. The British Aluminium Company Ltd (BACo), 58 per cent of whose shares are owned by Tube Investments Ltd, set up an aluminium smelter at Invergordon in 1968 with the help of a loan from the then Board of Trade and a special contract for electricity with the North of Scotland Hydro Electric Board (NSHEB).
- b. Around the same time two other smelters were set up: one by Anglesey Aluminium (jointly owned by Kaiser Aluminium and RTZ) at Holyhead with a special contract with the CEGB, and by Alcan at Lynemouth, Northumberland; in the latter case the company built its own power station and there was no special Board of Trade loan, but there was a special contract for cheap coal from the NCB.
- c. The Invergordon smelter has made an operating loss in 1981 estimated at £20 million; as a result BACo is likely to make a loss of some £30 million this year and wants to close the smelter.
- d. When the Invergordon smelter is closed the electricity contract will have to be terminated; BACo paid 20 per cent of the capital cost of Hunterston B nuclear power station in return for the right to the same proportion of its planned output; BACo is therefore entitled to a "residual value" in return for relinquishing this right, but certain payments due to NSHEB will have to be set against this to give a "net residual value".



e. A settlement has to be negotiated by 31 December 1981, the end of BACo's financial year; settlement in 1982 rather than in 1981 may expose BACo to an insupportable tax liability; in any case BACo may not be able to continue trading beyond the end of the year if the claims against it by the Scottish Electricity Boards remain outstanding.

2. In E(EA)(81)43 the Parliamentary Under Secretary of State for Industry (Mr MacGregor) proposed that the closure of the Invergordon smelter should go ahead. He discussed various options for terminating the contract. Although the Treasury would have been content with a settlement under which no cash passed in either direction, he proposed a net cash payment of £30 million on the grounds that this was desirable to avoid putting in jeopardy other BACo plants with a low rate of return, and prejudicing BACo's future investment plans.

3. In E(EA)(81)45 the Secretary of State for Scotland explained the serious consequences of closing the smelter but accepted its inevitability. He supported the proposal for a settlement on the basis of a net cash payment of £30 million. He also proposed assistance to mitigate the effects of the closure.

4. In his minute of 10 December the Secretary of State for Industry reported on the discussion the previous day in the Ministerial Sub-Committee on Economic Affairs (E(EA)(81)16th). Most E(EA) members were in favour of closure but the Secretary of State for Scotland was worried about the political and economic consequences. On the terms of a settlement no decision was reached but officials were instructed to work out the mechanics of both the "no cash" and "£30 million net payment" options. On support to mitigate the effects of closure, there was agreement that some assistance would need to be available, but the Chief Secretary argued that this would need to be found from within existing expenditure totals and that a clearer idea was needed on how the money might be used.

5. Over the past week the Secretary of State for Scotland's anxieties about the consequences of closure have increased. He had a meeting this morning with Lord Plowden and Mr Utiger (Managing Director of BACo). Mr MacGregor, Parliamentary Under Secretary for State for Industry and officials from the Treasury, DoI and Scottish Office were also present. The main purpose of the meeting was to explore the conditions under which BACo would be willing to keep the smelter open. In the light of the meeting, Mr Younger will be circulating a minute this evening comparing the costs of continuation with the costs of closure.



## MAIN ISSUES

6. The main issues are:

- a. whether the closure of the Invergordon smelter should go ahead; and, if so,
- b. whether the settlement should be on the basis of "no cash", or a net payment to BACo of £30 million, or some other basis;
- c. what special measures should be taken to alleviate the impact of the closure on the Invergordon area.

Should Invergordon be closed?

7. The closure of the Invergordon smelter would undoubtedly have serious consequences - the loss of 900 jobs directly and 500-600 indirectly, increasing the unemployment rate in the area to 25 per cent. Electricity demand in Scotland would be reduced by 7 per cent, with a possible loss of several hundred jobs in the power stations, and Scottish coal demand reduced by 15 per cent, leading either to further pit closures or an increase in the NCB's deficit. As the Secretary of State for Scotland has pointed out, some would argue that closing the smelter is itself costly because of the settlement with BACo, the need for extra help for the Invergordon area and unemployment costs. They might say that the money would be better spent on a continuing subsidy for the smelter, especially as the Anglesey Aluminium smelter is able to stay in operation by virtue of a more favourable contract with the CEGB than BACo's contract with NSHEB.

8. There are however very strong objections to keeping the smelter in operation. All evidence suggests that it is fundamentally uneconomic. Although the aluminium market is particularly depressed at the moment and this no doubt accounts for the very large operating loss (some £20 million) in 1981, Annex A of E(EA)(81)43 shows that, except in one year (1977), the operating profits have always been either meagre or negative and there has been a cumulative loss to the end of 1980 of some £13 million after taking account of central expenses and finance cost. This is in spite of the fact that, under the present contract, electricity costs for the smelter are subsidised at a rate of £8 million a year, compared with normal electricity costs for this type of user. In order to keep the smelter in operation BACo would require this subsidy to be increased to £14 million a year, at a cost per job for those employed at the smelter of some £16,000 a year. Unless this subsidy continues indefinitely, the once for all costs associated with closure will have to be incurred sooner or later.



9. There are also some broader considerations. The other two smelters will have the benefit of their present more favourable energy prices for only another year or two. It seems probable that the Alcan smelter at least will then become unviable. The position of the Anglesey smelter is less clear since, even when the energy prices under Anglesey Aluminium's contract with the CEGB have been doubled, they will still be less than those paid by BACo. But a subsidy for the Invergordon smelter is very likely to lead to a commitment sooner or later to do whatever is necessary to keep the other two smelters in operation. The Government would also find it difficult to explain why such large subsidies are available for the energy costs of aluminium smelting but not for many other industries whose competitive position would have been radically improved with much more limited help.

10. The Secretary of State for Scotland will draw attention to the political problems associated with closing Invergordon. He may be supported by the Secretary of State for Wales who is keen to see Anglesey Aluminium continue in operation. Most Ministers are however likely to take the view that the economic arguments are strongly in favour of closure and that the right course is both to negotiate a settlement with BACo which gives a reasonable chance of preserving most of its other operations and to provide some assistance to attract new employment to the Invergordon area.

#### Terms of settlement

11. The deadline of 31 December means in effect that a settlement has to be negotiated before Christmas and that the Government has to decide on the terms it is prepared to offer within the next day or so. Efforts have been made to see whether the deadline can be relaxed, and there have been discussions with the Inland Revenue. At present it seems inevitable that, unless the residual value of the electricity contract is settled before 31 December, BACo's tax liability will fall in 1982. Since the provisional view is that the residual value is likely to be treated as a capital gain, liability in 1982 would mean that the tax charge on BACo would be between £23 million and £29 million greater, depending on whether the settlement was on a "no cash" basis or a £30 million net payment basis. There is also the problem that delaying the settlement beyond 31 December could make it difficult or even impossible for BACo to continue trading.

12. The terms the Government is prepared to offer depend in part on the legal position. Departments are agreed that it would be undesirable to enter into litigation. It is also agreed however that the assurances given in the letter written by Edmund Dell as President of the Board of Trade on 23 July 1968 (copy



attached to Lord Plowden's letter to you and at Annex E of E(EA)(81)43) are not legally binding, and were deliberately intended not to be legally binding. There remains the question of the Government's good faith but it is doubtful whether this would justify a net payment of £30 million rather than a "no cash" settlement. It is also common ground that there is no firm commercial basis for estimating the residual value of the electricity contract since this depends on a large number of arbitrary assumptions about future electricity costs.

13. The main consideration affecting the terms of the settlement is therefore the consequences for BACo's other activities. The Department of Industry is concerned about other operations with a low rate of return at Falkirk, Warrington, Redditch and St Helens, involving over 2,000 jobs, as well as about BACo's future investment plans. An assessment was prepared for the Treasury by the Bank of England last week. The conclusion was that, although BACo might be able to survive, following a "no cash" settlement, it would be in a feeble state of health. The combination of high capital gearing and poor profits performance would put BACo in the bracket of other very weak companies of its size (such as Stone-Platt, Weir, Dupont, Chloride and Carrington Viyella). It would therefore be very vulnerable to any downside movements in the outlook for aluminium products. When Lord Plowden saw the Secretary of State for Scotland earlier today he said that a "no cash" settlement would almost certainly mean that BACo would have to close its operation at Falkirk with a loss of 1,100 jobs.

14. A net cash payment of £30 million is expected to improve the gearing from around 60 per cent to some 20 per cent and would undoubtedly put the company in a much sounder position. The justification for the figure is that it would reimburse BACo for the cost of redundancy payments at Invergordon amounting to £5 million; it would also make it possible to write off completely the cost of the smelter in BACo's balance sheet where it is valued at about £25 million. Even then the company might not be prepared to guarantee the continuance of the more vulnerable operations. Against this, the Chief Secretary is likely to argue that the first priority for additional public expenditure should not be to ease the problems of BACo but should be support for the Invergordon area. There may also be political and presentational difficulties in closing the smelter on a basis which leaves BACo in a position which appears too comfortable.



15. The best course might be to aim at a net cash payment rather less than the £30 million which BACo is seeking. It is thought that a net cash payment of say £15 million would improve BACo's gearing to some 37 per cent; this would not compare too badly with the average of 34 per cent for all companies with turnover, like BACo's, in excess of £150 million. The Chief Secretary may be unwilling to go as far as this but we believe that he would be prepared to offer a net cash payment of £5 million to reimburse BACo for the redundancy costs at Invergordon.

16. If the Committee is able to settle the level of net cash payment, if any, there will remain several detailed issues which need to be resolved by the Departments principally concerned - for example the gross residual value, which affects the Exchequer proceeds from the transaction although not the amount of public expenditure, and the need to ensure that the arrangements are proof against challenge within the European Community.

Support to mitigate the effects of closure

17. In E(EA)(81)45 the Secretary of State for Scotland originally made three proposals designed to mitigate the effects of closing Invergordon. One idea was to compensate BACo for phasing the closure over a period of six months or so in the hope that this would provide more time for a prospective purchaser of the plant. It is however now recognised that it is unlikely that a purchaser will be found for the smelter which is a highly specialised plant. Another idea was to set up an Enterprise Zone in the Invergordon area. It was however agreed by E(EA) that this proposal should not be pursued; partly because it went against the decision of E Committee (E(81)4th Meeting) that no further Enterprise Zones would be designated until the Government could assess the effectiveness of the existing ones and partly because Invergordon did not in any event appear particularly suitable for this kind of treatment.

18. The remaining proposal, subject to further clarification by the Secretary of State for Scotland, is that there should be assistance of some £5 million to attract new jobs to the Invergordon area, possibly in the form of an additional grant-in-aid to the Highland and Islands Development Board (HIDB). The Chief Secretary is sympathetic to this proposal subject to being satisfied in general terms about how the money might be used; this is under discussion between Scottish Office and Treasury officials. The Chief Secretary has also argued that this assistance should be found from within existing public expenditure totals but he is unlikely to make



that a sticking point, especially if the settlement with BACo is on a "no cash" basis or a basis involving only a small net cash payment.

## HANDLING

19. You might ask the Secretary of State for Industry to open the discussion and then invite contributions from the Secretary of State for Scotland and the Chief Secretary, Treasury. The Lord Advocate will be able to advise on the legal position. The Secretary of State for Wales may wish to comment on the implications for Anglesey Aluminium, and the Secretary of State for Energy on the implications for energy policy generally. You may want to ask Mr Ibbs to give his assessment of the balance of advantage for the national economy in relation to the various issues.

## CONCLUSIONS

20. You will wish to reach conclusions on the following points:

- i. whether the closure of the Invergordon smelter should be allowed to go ahead; and, if not, what subsidy should be provided;
- ii. if the closure is to go ahead,
  - a. what the terms of the settlement should be;  
("no cash", a net payment of £30 million, or some smaller net payment)
  - b. what support should be made available to mitigate the effects of closure on the Invergordon area;
- iii. how and when these decisions should be made known publicly and in Parliament.

PJG

P L GREGSON

14 December 1981